

Impact of Accounting Regulation in the Republic of Serbia on the Quality of Financial Reports for Strategic Management Purposes

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Abstract

The main purpose of the new accounting regulation that has been applied in the Republic of Serbia is the harmonization and improvement of the quality of financial reports for the needs of company management and external users of information (primarily, investors and creditors). Based on the above, the main goal of the research in this paper is to indicate whether the financial statements in the Republic of Serbia, which are based on the project of the Board for the Application of International Accounting Standards (IASB), can be compared with the financial statements in the European Union, and whether on that basis represent reliable informational support for strategic management. The research findings show that the immediate and exclusive application of IFRS in the Republic of Serbia has become a limiting factor in the informational power of financial reports for the purposes of strategic management. Based on the obtained research findings, it is possible to conclude that the accounting profession is to a greater extent dedicated to the traditional, classic requirements of the accounting function related to the preparation of financial statements, cost-financial control, while it is to a lesser extent dedicated to strategic management.

Keywords: strategic management, financial reports, accounting regulation, application of IFRS in the RS, EU Directive 34

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Strategic management represents a key determinant of the steady growth of the importance of financial statements. This is especially due to the fact that in the modern market conditions of business there is a separation of ownership and management functions in corporate business entities. In creating a modern market structure and market institutions, it is necessary to define a clear development policy and corporate management strategy (Hooley et al., 2017, p. 49). The market of various economic activities is in the spirit of a new restructuring, with a new consumer demand and purchasing power, to which a new package of product or service offers should be adapted. The market and its importance are increasingly determined by determinants related to uncertainty, product quality, and value creation for the consumer (Beckert, 2020, pp. 285–301). As a result, the future of companies of various economic activities will be followed by many novelties and trends in their offer and other factors that affect their sustainable development. By reducing barriers in international trade and thanks to information technologies, today it is possible to do business from a place in a certain country in another part of the world. A large number of companies located in the industrial and other sectors of activity have expanded their operations to other national economies. There are changes in the way of doing business and offering products under the influence of global environment, climate change, political and security and other developments. All this points to the need for harmonization of accounting practice in the world. The accounting system as the "language of business" should ensure a high degree of standardization, quality of information and full disclosure of transactions for the purposes of strategic management. It is clear that strategic management will rely on the development of new technologies, on innovation and knowledge, but also on a new system of financial reporting that is under the

explicit influence of accounting regulations. As Dečman (2013, p. 533) states, "it is possible to conclude that accountants are more dedicated to performing traditional tasks (compilation of financial statements, cost-financial control) while their participation in planning, and above all in decision-making, is represented to a lesser extent". The new system of financial reporting for the purposes of strategic management needs to include financial and non-financial parameters (Škriniar et al. 2008, pp. 738–754). It is known that the information obtained from the accounting information system is the most common basis for making business decisions. In addition to them, for the purposes of strategic management, non-accounting information plays a particularly important role, the use and application of which has been particularly emphasized in recent years. Financial and non-financial information for the purposes of strategic management have different significance depending on whether it concerns large and medium-sized enterprises or small entrepreneurs. Accounting regulations, as a presumption of the quality of financial reports for the purposes of strategic management, must take this into account. Large, medium and small companies are separate entities in terms of the organization and regulation of financial reporting. This primarily refers to external users (primarily investors and creditors). Therefore, the question arises to what extent small and medium-sized enterprises use the resulting information for the purposes of strategic management in the context of increasing the quality of their operations.

The main purpose of this paper is to determine the existing level of harmonization of accounting practice and explore new trends in the creation of financial reports that include both financial information and information of a non-financial nature. It regards formulating a new system that complements classical financial reporting and financial benchmarks with drivers of future performance, which is especially important when it comes to strategic management. As stated by Andjelković (2020, pp. 43-58), "Information from financial statements as a result of intangible assets is crucial for establishing long-term relationships with customers, and based on

that, creating and increasing the value of the company". From the stated goal of the research, the basic hypothesis in this work emerges, which indicates that for the purposes of strategic management, it is necessary to create such a structure of financial reports that will be based on the fundamental critical success factors related to both financial information and information of a non-financial nature (knowledge, new business processes, new technologies, innovations). The paper is structured in such a way that, in the first part, it indicates the current state of defining accounting regulations in the Republic of Serbia and the European Union. In the second part of the paper, the need for a new approach to accounting regulations is pointed out. It is a modern approach that results in more complete financial reports that would include both financial and non-financial parameters for the needs of strategic management. All of this results in the formulation of such a model of financial reports that will indicate the need to revise certain international accounting standards that business entities are faced with today. According to Palea (2018), the group of high ranking experts on sustainable finance (HLEG, 2018) indicated the need for better consideration of sustainability issues in accounting standards.

The main purpose of the new accounting regulation that has been applied in the Republic of Serbia is the harmonization and improvement of the quality of financial reports for the needs of company management and external users of information (primarily, investors and creditors). Based on the above, the main goal of the research in this paper is to indicate whether the financial statements in the Republic of Serbia, which are based on the project of the Board for the Application of International Accounting Standards (IASB), can be compared with the financial statements in the European Union, and whether on that basis represent reliable informational support for strategic management. The research findings show that the immediate and exclusive application of IFRS in the Republic of Serbia has become a limiting factor in the informational power of financial reports for the purposes of

strategic management. Based on the obtained research findings, it is possible to conclude that the accounting profession is to a greater extent dedicated to the traditional, classic requirements of the accounting function related to the preparation of financial statements, cost-financial control, while it is to a lesser extent dedicated to strategic management.

The Existing State of Quality of Financial Reports for the Needs of Strategic Management

In the long history of financial reporting, the basic objective of financial reporting has basically remained unchanged (Cvijić, 2017, p. 53). Today, as before, financial reports are expected to provide company management and external users with the information needed for strategic management and business decision-making. The number of users of financial reports and the information requirements on which strategic management and strategic decision-making are based have radically increased in recent years. There are several factors that have contributed to the increase in the number of users of financial statements. However, it seems that the development of the market economy, the constant growth of the size of companies, expressed through the amount of capital employed, and the turbulent environment have a decisive influence. The emergence of increasingly frequent economic and financial crises in the 20th and 21st centuries contributed to the “bankruptcy” of a large number of highly profitable companies. The analysis of business and other factors in the environment is set as a necessary condition in considering the possibility of companies to get out of the zone of losses (Djuričin, 2012, pp. 34-45). In this context, Stiglitz (2009, pp. 281-296) poses the question why, when it comes to the financial crisis, lessons are not drawn from economic theory. According to Kovač (2018, pp.127-139)

Unrealistic assumptions about the rational behavior of producers and consumers and about the perfect functioning of the market are explained by the fact that the neoclassical theory did not try

to look at the causes of financial crises. It is precisely the non-fulfillment of those conditions that explains most of the economic and financial crises.

This approach and failure influenced international financial institutions and organizations, such as the IMF and the World Bank, to point out the necessity and need for the development of national and international accounting regulations that would affect the process of standardization and harmonization of financial reports. The process of standardization and harmonization of financial reports has been mainly influenced by globalization, increased competitiveness, and technological progress. The main purpose of the mentioned approach is to create quality financial reports for the needs of strategic management of corporations in all sectors of the economy.

Information on the financial position and success of the company's operations, presented in financial reports, has always been of great importance to the company's management and external users, especially investors. Meeting the needs of external users of information, especially investors, has become an imperative of accounting regulation when it comes to financial reporting. This led to a review of the previously valid rules for recognizing and evaluating elements of financial statements, which represents a key determinant of strategic management. Hence, one of the fundamental areas of international financial accounting research is to point out the similarities or differences in the application of asset measurement models and principles of different countries. When it comes to concrete empirical research, Sačer & Zyznarska-Dworczak (2020, p. 41–64) indicate the principles of assets measurement according to Croatian and Polish accounting standards. The findings of the research is the introduction into the measurement system the elements of financial statements, in addition to the historical cost and fair value that has been dominant. The use of fair value as a basis for valuation appears first as a right of choice, and then as an obligation for certain forms of assets and liabilities. Today, fair value represents the basis of a new concept of financial reporting (Škarić-Jovanović, 2009, pp. 414–432). In the contemporary international

accounting literature, a particularly important question from the aspect of strategic management and development of the company refers to which model for estimating the value of the company's or entity's capital should be applied, i.e. what are the advantages of applying the fair value model compared to the historical cost model. The mentioned area of research has a significant impact on predicting the future growth and development of the company. Should the fair value or purchase value of the capital be taken as a basis for evaluating the sustainable development of the company or for predicting its future. Also, investors on the world market are particularly interested in information that serves the needs of strategic management and is used on that basis in making strategic decisions, based on standards that are recognizable in their country and compatible with other countries. It is necessary to take into account the fact that between individual countries there are cultural differences and other environmental factors that predetermine the application of IFRS. In the case of the International Accounting Standards, and the International Financial Reporting Standards, it is necessary to follow an approach based on fundamental foundations or principles, which primarily determine the content of the financial statements of each company.

A major contribution to the definition of professional accounting regulation has been made by the Board for the Application of International Accounting Standards (IASB), that is, its project of International Financial Reporting Standards, which also includes International Accounting Standards (IAS/IFRS). Therein, the International Federation of Accountants (IFAC) played a major role, which has established the accounting principles through standards and thereby harmonized accounting, that is, the system of preparation and presentation of financial reports. According to Wayne et al. (2012, pp. 68–93). When it comes to activities in defining professional accounting regulations, the influence of other well-known accounting institutions in the world, that is, their boards on the harmonization of International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles US GAPP, should be mentioned. In addition to AISB's project related to the application of international financial reporting standards,

Directive 34 of the European Union (EU Directive 34, 2013) has a fundamental role in the current state and development of professional regulation. A large number of the EU allows (does not prescribe) the application of IAS/IFRS for the purposes of drawing up consolidated financial statements for companies that are not listed on the stock exchange. The comparability of financial statements as one of the means of communication between companies of the member states of the European Union is constantly increasing, especially in terms of the importance that comes from it for their users. If the financial statements do not contain all the information that the users need, they provide the necessary framework by which users of information can compare specific information obtained from other sources (Kothari & Barone, 2012, p.1). In that process, the International Federation of Accountants (IFAC) plays a key role, which has established accounting principles through standards and thus largely harmonized accounting, that is, the system of preparation and presentation of financial reports.

Unlike the European Union, the Republic of Serbia accepted IAS/IFRS as the only financial reporting framework for all companies (Accounting Act, 2013, 2019, 2021). According to the aforementioned Law on Accounting, information for the purposes of strategic management comes from the following set of financial reports: Balance Sheet and Income Statement as basic financial reports on profitability and financial operations of the company; Statement of other comprehensive income; Statement of changes in equity; Statement of cash flows; Notes to the financial statements important for the assessment of the financial position and success of the company's operations. With the adoption of the new Law on Accounting (2021), the efforts to achieve full harmonization of financial reporting have been continued. For recognition, valuation, presentation and disclosure of positions in financial statements, there are special International Financial Reporting Standards for medium and small enterprises, approved by the International Accounting Standards Board (IASB). We believe that the application of the above standards is not aligned with the needs and interests of companies, depending on their size, especially when it comes to small companies and micro-entrepreneurs. The stated statement has

been confirmed by numerous empirical studies bearing in mind the IFRS approved by the IASB. According to Mamić et al. (2015, pp. 593–607), empirical research confirmed that the simplification of accounting regulations is justified, because it would have an impact on reducing costs. The value of the quality of information due to the simplification of accounting regulations will not be lessened. Also, the standards of accounting regulations in the Republic of Serbia are not aligned with the aspect of harmonization and standardization of financial statements with many key determinants of Directive 34 of the European Union. This certainly affects the quality of information from financial reports from the aspect of comparability with the financial reports of other participants in the international market, especially those listed on the stock exchange. From that aspect, the question of the quality of this segment of information from the financial report for the needs of strategic management also arises. In recent decades, there has been a negative trend in the relationship between stock prices and key financial indicators, such as earnings, book values or cash flows. The weakening of the mutual connection shows that the role of information based on financial reports is decreasing in the process of making strategic decisions of investors. In the Republic of Serbia, the Translation of the Conceptual Framework for Financial Reporting and the basic texts of the IAS, i.e. IFRS (2014) has been published. According to Dragojević et al. (2012, p.203), the new international standards of financial reporting should provide a key contribution to more correct and precise compilation of financial reports in the coming period, in order to create preconditions for strategic management and, on that basis, making more reliable financial and business decisions in the future.

Improving the Quality of Financial Reports for the Needs of Strategic Management

In previous discourse related to professional accounting regulation, the focus of research was traditional, classic financial reports. However, in the modern business environment, strategic measures of success are the primary focus of strategic management, many of which are non-financial measures of business success, such

as research and development of new products, innovations, knowledge, customer satisfaction, etc.). According to Vunjak & Ostojić (2014), what is important from the aspect of strategic management is that “the focus of financial reporting and operations should take into account both financial indicators (liquidity, solvency, profitability) and non-financial indicators”. Managers are increasingly realizing the lesser usefulness of information based on financial statements for the purposes of strategic management, proposing a revision of accounting regulations and international financial reporting standards (IFRS). Palea (2018), states that in the work of Gauzès (2017), it is outlined that “the chairman of the Board of the European advisory group for financial reporting specifically pointed out the important statement that the research indicates that it is necessary to overcome the traditional, classic approach whose focus is traditionally technical accounting”. In other words, it is necessary to explore a new approach to financial reporting for the purposes of strategic management. In this direction, it is necessary to revise the existing IFRS and consider the concept of the broader impact of IFRS on the economy. We believe that for the purposes of strategic management, it is necessary to define additional or alternative performance measures in relation to generally accepted accounting principles - US GAPP and the International Federation of Accountants (IFAC), which established accounting postulates through standards and thereby harmonized the system of preparation and presentation of financial statements.

The existing framework of financial reporting should be expanded and adapted for the needs of strategic management. In this context, the application of the balanced scorecard model (Balanced Scorecard – BSC) is a good example of research into alternative possibilities of a performance measurement system that would complement financial reports, in the function of implementing strategic intentions and strategic management. To highlight the importance of applying strategic information, both financial and non-financial, accounting reports on business performance are often now based on critical business success factors grouped into four different

perspectives (financial perspective, customer perspective, internal processes, and learning and development). One dimension includes financial information and the other non-financial information. A system that complements the conventional classic financial reporting and financial benchmarks with drivers of future performance was created under the name Balanced Scorecard – BSC (Domanović, 2010; Kaplan, 1996). The focus of the mentioned approach is the balancing of all factors that form the basis of the growth and development of corporations. It is a scorecard that provides a basis for a more complete analysis of the effectiveness of measures for the purposes of strategic management than is possible on the basis of only financial data from a conventional financial report. The application of the above mentioned scorecard is a critical element of a comprehensive approach to strategic management in order for companies and other entities to survive and become competitive in their market.

In the modern market conditions of business, there is a separation of ownership and management functions in corporate business entities. The financial dimension of shareholder value creation is the outcome that every company's strategy should achieve. Businesses usually choose one comprehensive indicator as a long-term indicator of success. Previously, this referred to ROI or ROCE performance indicators. Today, companies generally use some alternative value-based management indicator, such as economic value added (EVA), cash return on investment (CFROI) and discounted cash flow variances (Kaličanin, 2003). In a strategic management, a company or other entity applies the Balanced Scorecard model to introduce new business strategies. According to Renko (2000, pp. 1239-1255), it is common to approach "two strategies: the strategy of revenue growth, and the strategy of attracting and retaining customers through the assortment of products /services". The process of developing the Balanced Scorecard model for each of the listed strategies is "aligned" with the performance measures and goals of the four levels of business (level of financial perspective, customer perspective, internal processes and learning

and development). At the financial level of business, the goals of increasing the source of income are set by expanding the range of new products and services. From the perspective of the customers' perspective, the core of any company's strategy is the creation of value for the customer. As stated by Andjelković & Vujić (2019, pp. 414–431) "In this context, customer satisfaction is a determinant of value in the market and an indicator of future revenues and profits of the company". Measuring customer profitability is an activity that provides an additional and new dimension to the future of business operations. In this way, a mutual connection is established between the non-financial and financial dimensions in the function of increasing the value of the company. For the purposes of identifying strategically important categories of customers, different analysis methods and indicators can be used, such as the RFM method, Customer lifetime value (CLV), and ROI analysis. Choosing the right customer lifetime model (CLV) is a key issue for companies.

Considering that customers are directly or indirectly connected with every value creation activity of the company, the value of the relationship with the customer should be analyzed in the same way as the value of the company's operations. According to Kothari & Barone, (2012, p. 11), David Packard, co-founder of Hewlett-Packard Company, said: "Profit is not the real aim and purpose of management – it actually means that all the real aims and purposes are achievable". According to his vision, the true purpose of a company is to create value for its customers and to make a profit as a result (Margaretta, 2002, pp. 86–92).

Bearing in mind the role of accounting in creating a company's competitive advantage, Lukić (2011, pp. 55–64) states:

The strategic cost management system creates strategic information, financial and non-financial in nature. In the past, the focus was on financial performance measures, such as sales and earnings growth, cash flows, and share price. In contrast, in the modern business environment, strategic

measures of success are primarily the focus of the company's strategic management, many of which are non-financial measures of business success, such as market share, product quality, customer satisfaction and opportunity growth.

On the basis of the above, it can be concluded that in addition to the mentioned conventional or classical approach to financial reporting behind the AISB's IAS/IFRS project, this work particularly highlights the need for a new integral approach to financial reporting. The progress related to the previously mentioned approach of conventional financial reporting can be observed in one of the set of financial statements provided by IAS/IFRS, which refers to "Notes to financial statements" (Accounting Law, 2019, 2021). Based on the content of the information in the Notes, it can be concluded that the Notes to the financial statements contain relevant, i.e. essential information for a more complete understanding and assessment of the financial position, earning power and flow of funds of each company, for a more reliable prediction of its future conditions and achievements. It is of particular importance from the aspect of strategic management. The impact of the Notes is very important, considering that it increases the informational power of the data contained in the financial statements related to "Disclosures". In this way, the users of financial reports have a clearer picture of the financial, asset and profitability position of each company. Related to the previous statement, Andjelković (2020, pp. 46–47) states: "In this context, financial and non-financial information contained in the Notes should improve the transparency of financial reports, as well as inform users about the intentions of the company's management regarding future business results and ways of managing resources". This is especially important in the current conditions of a complex external environment in which companies "under conditions of uncertainty in future outcomes" strive to secure a competitive advantage on the market through strategic management.

Companies today are not only focused on profit, but also on other factors of sustainable development. In this context, non-

financial reporting becomes a new source of information for the strategic management of company development.

According to Vuković et al. (2020 pp. 41–58)

non-financial reporting contains information on relevant measures that affect the development of business and its results, effects of business from a social and environmental aspect, necessary tools for understanding development, business results and the position of the company. The market and the regulatory framework exert a strong pressure on the development of sustainable accounting, which is becoming more and more accepted in modern business practice.

From that aspect, the new concept imposed the need for an integral approach to financial and non-financial dimensions in the creation and creation of company value. The new approach to the analysis of business efficiency and the strategic management system introduces financial calculations and other non-financial dimensions of the company, thereby establishing a dialogue between them and finance.

According to Cvitanović (2018, pp. 83–94), “a better understanding of the accounting and financial aspect of marketing can improve the cooperation of the marketing function with other business functions”. Determining the contribution of marketing activities to the company's financial results and reporting it clearly will make the marketing function more credible. An integral approach to financial reporting includes determinants that, among other things, relate to the intersubjective construction of value. The measured values of information from financial reports are influenced by various so-called strategic variables. Among the more analyzed so-called of strategic variables, which increase financial indicators, research and development, innovation, knowledge, customer satisfaction stand out. In this way, we would like to point out that the results of modern research on accounting regulations indicate that it is necessary to

include information related to non-financial performance measures in financial reports. In this direction, Bernard & Roland (2016, p. 441), in their research, come to the results that indicate the necessity of reviewing the current field of finance from the aspect of the importance of information from financial reports in the context of “a new perspective and sustainable finances”. This approach would contribute to a more reliable information base for the needs of strategic management. As a result, the new approach introduces financial calculations into the domain of other dimensions of the company, thus establishing a dialogue between them and finance.

Conclusion

International accounting regulations represent a strategic component of the quality of financial reporting for the needs of strategic management. Regarding the Republic of Serbia, based on the research in the paper, it can be concluded that the existing legal and professional accounting regulations cannot ensure a high degree of standardization and harmonization of financial reports that would contribute to the quality of financial information for the needs of company management, especially external users (before all, investors and creditors). The aforementioned conclusion stems from the fact that the Republic of Serbia has accepted AISB's IAS/IFRS project as the only framework for financial reporting of all entities, without taking into account other key international accounting regulations. First of all, it refers to Directive 34 of the European Union and aligned with it to the USA generally accepted accounting principles (US GAAP). Likewise, the new accounting regulation in the Republic of Serbia did not take into account its previous rich accounting practice, and on that basis the existence of its own national accounting system.

Also, the findings in this paper point to a conclusion that implies a revision of the existing accounting regulation in the Republic of Serbia, which is based on the AISB's IAS/IFSI project, and on that basis financial reports in order to achieve greater expressive power

for the needs of strategic management. It is necessary to overcome the existing concept of conventional, technically oriented accounting and to consider the issue of a broader expressive power of financial reports by including other determinants of non-financial characteristics (research and development, innovation, knowledge, customer satisfaction). The Balanced Scorecard model is a good example of an integral performance measurement system, which, among other things, serves the purpose of implementing strategic intentions and predicting the future. Business uncertainty and the turbulent environment in which companies find themselves have imposed an integral approach to financial reporting for the purposes of strategic management. Financial statements as a result of traditional, classical accounting were not able to fully satisfy the needs for strategic information and future forecasting. Research findings in the paper confirms the hypothesis that the strategic management of the future is based on financial reports that will include, on the one hand, the financial dimension of the company's operations, and on the other hand, determinants of a non-financial nature. In that process, it is necessary to review the current areas of finance in the context of a "new perspective and sustainable finances", which would contribute to a more reliable, objective informational basis for the needs of strategic management.

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Uticaj računovodstvene regulative u Republici Srbiji na kvalitet finansijskih izveštaja za potrebe strateškog upravljanja

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Sažetak

Osnovna svrha nove računovodstvene regulative koja se primenjuje u Republici Srbiji je harmonizacija i unapredjenje kvaliteta finansijskih izveštaja za potrebe menadžmenta preduzeća i, eksternih korisnika informacija (pre svega, investitora i kreditora). Polazeći od navedenog, osnovni cilj istraživanja u ovom radu je da ukaže da li finansijski izveštaji u Republici Srbiji koji se zasnivaju na projektu Odbora za primenu Međunarodnih računovodstvenih standarda (IASB), mogu biti uporedivi sa finansijskim izveštajima u Evropskoj uniji, i dali na toj osnovi predstavljaju pouzdanu informativnu podršku strateškom upravljanju. Rezultati istraživanja pokazuju da je neposredna i isključiva primena MSFI u Republici Srbiji postala ograničavajući faktor informacione moći finansijskih izveštaja za potrebe strateškog upravljanja. Na osnovu dobijenih rezultata istraživanja moguće je zaključiti kako je računovodstvena profesija u većoj meri posvećena tradicionalnim, klasičnim zahtevima računovodstvene funkcije koji se odnose na sastavljanje finansijskih izveštaja, troškovno-financijsku kontrolu, dok je u manjoj meri posvećena strateškom upravljanju.

Ključne reči: strateški menadžment, finansijski izveštaji, računovodstvena regulativa, primena IFRS u RS, Direktiva 34 EU